

September 8-9, 2005

## **Improving Medicare's adjustments for geographic differences in underlying wage levels**

**ISSUE:** Medicare adjusts prospective payment rates for differences in the underlying wage levels across geographic areas. To arrive at an adjustment factor, the area's "wage index" is multiplied by a stated "labor share." The "wage index" should reflect market prices for labor faced by each type of provider. The "labor share" is the proportion of the total Medicare payment that is adjusted by the wage index. It should reflect the share of a provider's costs that would be labor related if the provider were in a market with average wage rates. We will first focus on the hospital wage index and labor share, because many of the other Medicare prospective payment systems use the hospital wage index as the basis for their cost of labor adjustments.

There are several issues with the current hospital wage index and labor share geographic adjustment system arising from the way the data are collected, the labor area definitions, the correction to adjust for the mix of occupations, the computation of the labor share, and the legislated use of multiple labor shares.

**KEY POINTS:** We will discuss the policy questions and analytic approach we plan to follow to address this issue. The policy questions are:

- Should Medicare continue to measure differences in the cost of labor among geographic areas using hospitals' self reported average wage rates, or should it create wage indexes based on census or BLS wage data weighted for a fixed set of occupations?
- What percentage of Medicare payments should be adjusted for differences in wage rates among areas? In other words, what should the "labor share" be?
- Should Medicare have a common method for adjusting payments to all types of providers for geographic differences in underlying wage levels?

**ACTION:** We would appreciate comments and suggestions from the Commission on our approach.

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